



# International Finance

Vol. XVI, No. 23  
November 23, 1981

Issued biweekly by the Economics Group of The Chase Manhattan Bank for corporate customers and correspondent banks. Managing Editor: David M. Cheney

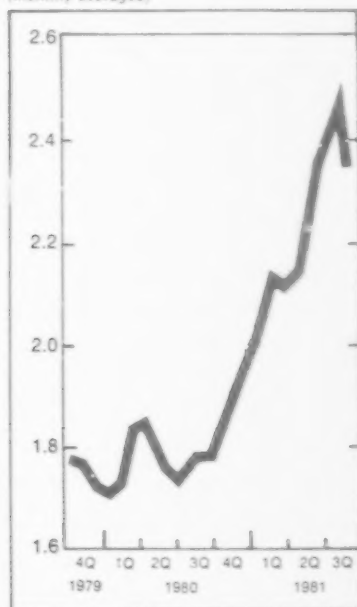
## The U.S. Dollar Outlook

The recent decline of the dollar on foreign-exchange markets has raised concerns about the emergence of a period of pronounced and sustained dollar weakness. Some observers have argued that "fundamental" economic influences will dominate throughout 1982 and place continued downward pressure on the dollar. In support of their predictions of dollar weakness, these analysts most frequently cite the anticipated swings in the current-account balances of both the United States and Germany—with the expectation of a worsening in the U.S. balance coinciding with an upturn in the German current account.

A major problem with this prevalent view—that future current-account imbalances will lead to sustained dollar weakness—is that it neglects entirely the role of foreign-exchange market expectations. Indeed, it implicitly assumes that market participants are "myopic", that is, unable to take into account the impact of such future events as current-account imbalances until they actually occur. In practice, however, just the opposite is true. Such anticipated developments as future current-account imbalances are quickly discounted by the foreign-exchange markets and are immediately reflected in the spot and forward markets. Thus, since a market consensus already foresees an improvement in the German current account next year and a worsening in that of the United States, these developments should have little further effect on the dollar when they actually occur—unless the market's expectations are far off target.

Putting aside the current-account argument for a major decline of the dollar, market expectations of the major influences on the demand and supply of dollars—future inflation and real growth differentials—do not pre-empt major dollar weakness. Although the dollar may decline in the near term, especially if the United States experiences a much sharper recession than expected, realized inflation differentials favoring the United States should place a limit on dollar weakness. Indeed, if the U.S. economy performs with unexpected buoyancy in 1982, excess demand for dollars may develop on foreign-exchange markets that may very well lead to substantial dollar strength, despite an even weaker U.S. current account.

DM/dollar  
exchange rate  
(monthly averages)



*Bearish German  
growth forecasts  
may prove pessimistic.*

*Restrictive Irish  
budget expected  
to halt economy's  
deterioration.*

*Portuguese  
economy on re-  
trenchment course.*

*Japan's domestic  
economic slump  
helps boost its  
external position.*

German economic growth forecasts for 1982 have been revised downward. The government's official forecast for real GNP growth has been trimmed to 1%-2%, and the latest joint report by Germany's five research institutes forecasts real growth of only 1%, with one institute actually forecasting a decline in real GNP. The forces underlying this downward revision include weaker than previously expected growth in world trade, a restrictive 1982 budget, and the high level of real interest rates—seen for both Germany and abroad. While evidence does point to a delay in Germany's economic recovery, the more pessimistic forecasts may well underestimate the favorable impact of a stronger DM on Germany's inflation rate, and the resulting boost to real incomes and consumer demand in the latter part of 1982.

Despite the narrow majority enjoyed by Ireland's coalition government, a tough budget was introduced this past July to halt the steady widening in the balance of payments and in the budget deficit. The budget increases taxes sharply, and raises prices charged for public-sector services. The restrictive budget will check economic growth in 1982 and is likely to produce a peak inflation rate of about 22%. It is, however, expected to improve the government's finances and the current-account balance, thereby reversing the steady deterioration in the Irish economy that has occurred since 1979. In the longer run, Ireland faces stubborn problems. The service charges on its overseas debt—some £250 million (2.5% of GDP)—will nearly double next year, further straining the balance of payments. And wage settlements, although running below the inflation rate, will raise the growth rate of unit labor costs well above those of many of Ireland's EEC partners. Consequently, several more restrictive budgets are anticipated before the path is cleared for a more sustained economic expansion.

After a strong performance in 1980, the Portuguese economy is now mired in difficulty. The expansionary policies of last year, the impact of world recession, and a severe drought have pushed the balance of payments into a deficit that is officially forecast to reach \$1.7 billion in 1981. GDP growth, which reached 5.5% in 1980, is unlikely to reach even 3% this year, particularly with exports depressed in the face of weak European demand. Inflation, which had receded to 16.6% in 1980, is now climbing steadily again; it reached 23.6% in September, year on year. In response to this scenario, the new government has designed a deflationary budget aimed at cutting the ever-widening public-sector deficit. While reluctant to raise income taxes, the budget calls for higher purchase taxes on luxury items, a freeze on civil service hiring, and reduced deficits in state-owned industries.

Although Japanese domestic demand is recovering slowly, it remains weak. Plant and equipment investment by large firms is vigorous, but investment by small firms is sluggish. Public works spending, concentrated in the first part of the fiscal year, is no longer providing as much stimulus to growth. Housing remains depressed, with housing starts in September down for the sixth consecutive month to only 91,800, down 5.6% from a year earlier. Real income and consumer spending have been sluggish, despite a sharp slowdown in inflation, because of a reduction in overtime and bonus payments. In August, average real expenditure by all Japanese households fell 1.3% from a year earlier, the third consecutive monthly decline. In September, however, consumer spending showed some signs of recovery, with retail sales up 9.4% and new car sales up 12.3% from a year ago. As the anticipated pickup in consumer spending spurs industrial production, imports may accelerate. Meanwhile, Japan's external accounts have benefited from the slow recovery of the domestic economy and the weakness of the yen against the dollar, and a current-account surplus of some \$7 billion is projected for 1981.

*Shortfall in Mexican  
oil earnings triggers  
austerity measures.*

Various indicators of the Mexican economy are clearly pointing to a growth slowdown this year. The twelve-month moving average for industrial production fell to 8.3% this past June from 9.6% in June 1980. The similar manufacturing average has dropped to 5.4% from 8% over the same period. These slowdowns are the result of the government's response to the unexpected interruption of oil exports this past summer. The shortfall cut \$4 billion from anticipated oil export receipts in 1981, prompting a \$4-billion reduction in spending and a shift toward monetary restraint. Such restrictions, however, are expected to help reduce the rate of inflation, which has accelerated to 28% because of strong demand pressures. On balance, real GDP growth of about 6.5% is projected for 1981, below last year's 7.4%, but still impressive by world standards.

*Colombian current  
account swings  
into deficit.*

The decline in world coffee prices and higher interest payments on debt have been major contributors to Colombia's growing current-account deficit. The current-account gap of \$715 million recorded for the first nine months of 1981 is in sharp contrast to the \$543-million surplus for the year-earlier period. The swing into deficit, however, was not unexpected. Coffee prices have been falling during most of the past year, owing to excess supply. And non-coffee export earnings have dropped by 2%, partly the result of lower gold prices and export manufacturing sluggishness. At the same time, Colombian merchandise imports have increased by about 17% because of programmed investment spending economy-wide. The resulting current-account deficit has been financed easily, however. And although international reserves have dipped slightly, they are still a strong \$5.2 billion, sufficient to cover 16 months of imports.

*New Zealand's  
export dependence  
dictates recent  
policy decisions.*

The recent dramatic slowdown in New Zealand's agricultural exports—on which the country is highly dependent—is an important contributor to the country's domestic economic stagnancy and its widening current-account deficit. The government has responded to the problem in several ways. It has purchased \$156 million of surplus butter from the United States to prevent the further decline of world prices for butter (a key export); and it has decided to finance a high-risk \$1-billion synthetic fuels project, to spur energy and mining development and promote export diversification. The authorities have conceded to the signing of the General Agreement on Tariffs and Trade (GATT) export subsidy code, which commits them to phase out gradually the country's export subsidy. Nonetheless, the government is expected to develop alternative measures of export promotion.

*Surge in oil  
export earnings  
and new finds  
for Tunisia.*

The increase in oil output and sharply higher prices since 1979 have made petroleum Tunisia's chief foreign-exchange earner. Production of the country's relatively high-quality crude has remained constant at an average 115,000 barrels per day over the last three years, but the 1979 surge in prices helped produce gross oil revenues of \$1.1 billion in 1980, equivalent to 51% of total exports. In view of the marked depreciation of the Tunisian dinar relative to U.S. dollar this year, a similar windfall is projected for 1981. At the same time, however, domestic oil consumption has been rising rapidly—at an average annual rate of 12%. Greater local needs have been met through imports of both crude oil and refined products, the values of which have also risen sharply; such imports currently absorb nearly 55% of gross oil export revenues. Tunisia had been expected to become a net oil importer by the mid-1980s, owing to the levelling off of oil output from existing fields and the rapid growth of domestic consumption. However, the recent uncovering of two major deposits will keep it a net oil exporter beyond the 1980s. Although testing has not been completed, the first find (in the Chott Jerid dry lake area) is expected to yield at least 50,000 bpd by 1983. Further brightening the energy—and, thus, balance-of-payments—outlook are the recent discoveries of large amounts of natural gas.

## Farmers in Financial Straits

Thanks to good weather and an expansion in acreage farmed, U.S. farm production in 1981 has bounced back to record levels from 1980's drought-reduced harvest. This is good news for American consumers. But for many of the nation's farmers, it signals continued financial difficulty, both this year and next.

Abundant supplies in the face of weak demand, both at home and abroad, have maintained downward pressure on commodity prices—now about 6% below year-ago levels. There has been some easing in farm input cost rises, as prices of fuel and energy-related products have stabilized. But the added costs of persistently high interest rates on expanding farm debt have more than offset the slowdown in input prices. And for the second year in a row, production expenses are expected to outpace cash receipts from the sale of crops and livestock. The U.S. Department of Agriculture projects that net farm income in 1981, even after adjustment for inventories, will be only modestly higher than last year's \$19.9 billion and well below the recent peak of \$32.7 billion in 1979.

Traditionally, farmers have coped with short-term fluctuations in income by borrowing against farm equity to cover production loans. But such borrowing has become more difficult because of a slowing in the rate of increase in farm land values, as well as high interest rates and expectations that low commodity prices will

continue into 1982. Some of the more highly leveraged farmers have been caught in a cash-flow squeeze. And there are indications that delinquencies and defaults in the farm sector may be on the rise.

Of course, not all farmers are affected to the same degree by illiquidity and low levels of net income. The financial health of individual farms varies widely, and aggregate statistics are often misleading. Nevertheless, 1981 has indeed proved to be hard year for some farmers—particularly new entrants to farming and farmers who have recently made large purchases of capital equipment at high interest rates.

At present, the outlook for 1982 is not much better. Given the prospect of lackluster recoveries in the United States and abroad, little growth in demand for American agricultural products is likely. And with this year's bumper harvest, farm prices are expected to remain low, with increases in cash receipts limited. At best, only moderate improvement in production costs can be expected as interest expense for farmers will continue to rise for some time. Thus, farmers may well be faced with a third consecutive year of cash-flow problems. As always, a number of variables—including the size of the prospective Southern Hemisphere harvests, changes in trade and agricultural policy, the value of the dollar, and the weather—could alter the picture substantially.

## Europe, Canada & U.S. Bimonthly Survey of Business and Finance

| COUNTRIES     | CURRENT BUSINESS CONDITIONS                                                                           | INDUSTRIAL OUTPUT |                 | GNP IN 1980            |             | BALANCE OF PAYMENTS |                                    |                 |                           |
|---------------|-------------------------------------------------------------------------------------------------------|-------------------|-----------------|------------------------|-------------|---------------------|------------------------------------|-----------------|---------------------------|
|               |                                                                                                       | latest data       | 12-month change | in billions of dollars | real growth | latest data         | reserves (less gold) in \$ million | 12-month change | months of imports covered |
| Austria       | Proposed 1982 budget is mildly restrictive; 1982 real growth of 2% assumed.                           | Mar.              | + 1%            | 75.8                   | + 3.6%      | Sept.               | 4,352                              | - 8%            | 2.5                       |
| Belgium       | New coalition sought after inconclusive general election; 1982 growth prospects poor.                 | Aug.              | - 10%           | 118.7                  | + 2.0%      | Sept.               | 5,167                              | - 37%           | 1.0                       |
| Britain       | Trough of recession reached, but few signs of sustained recovery evident.                             | Sept.             | - 2%            | 519.6                  | - 1.4%      | Sept.               | 15,294                             | - 29%           | 1.7                       |
| Denmark       | Economic output remains depressed, but new orders are rising quickly.                                 | June              | + 10%           | 64.7                   | + 0.2%      | Sept.               | 2,453                              | - 23%           | 1.6                       |
| Finland       | Exports continue to bolster economy, but their rate of growth is slowing.                             | July              | - 3%            | 51.0                   | + 6.0%      | Sept.               | 1,510                              | - 22%           | 1.3                       |
| France        | Pick-up in consumer spending leads economic recovery.                                                 | Aug.              | - 6%            | 651.1                  | + 1.2%      | Sept.               | 21,869                             | - 21%           | 2.3                       |
| Germany       | Economy slowed in second and third quarters; official 1982 real growth forecast revised down to 1.5%. | Sept.             | - 2%            | 822.2                  | + 1.8%      | Sept.               | 47,154                             | - 4%            | 3.5                       |
| Greece        | Socialist party gains absolute majority in parliamentary elections; new policies not yet detailed.    | Dec.              | + 3%            | 38.2                   | + 1.6%      | Sept.               | 1,476                              | + 24%           | 2.1                       |
| Ireland       | Economic activity slowing further in wake of July's restrictive budget.                               | May               | - 2%            | 17.1                   | + 2.1%      | Sept.               | 1,966                              | - 24%           | 2.2                       |
| Italy         | Domestic economy remains weak; Parliament votes income-tax reductions.                                | Sept.             | + 1%            | 394.9                  | + 4.0%      | Aug.                | 19,057                             | - 12%           | 2.5                       |
| Netherlands   | Post-election coalition re-formed after initial failure to agree on 1982 budget.                      | Sept.             | + 1%            | 159.9                  | + 1.0%      | Sept.               | 8,443                              | - 26%           | 1.5                       |
| Norway        | Real GDP expected to expand by only 0.5% this year and by 1% in 1982.                                 | Aug.              | - 9%            | 55.4                   | + 3.6%      | Sept.               | 5,463                              | + 8%            | 4.5                       |
| Portugal      | Deflationary 1982 budget announced.                                                                   | Mar.              | - 2%            | 24.1                   | + 3.9%      | Aug.                | 869                                | - 1%            | 1.1                       |
| Spain         | No indications as yet of any economic upturn.                                                         | Dec.              | + 5%            | 208.5                  | + 0.5%      | Aug.                | 11,018                             | - 16%           | 4.1                       |
| Sweden        | Devaluation and tax cuts should bolster domestic activity.                                            | July              | - 8%            | 124.3                  | + 2.3%      | Sept.               | 4,049                              | + 13%           | 1.8                       |
| Switzerland   | Business slowdown now evident and likely to continue past year-end.                                   | June              | 0               | 100.5                  | + 2.4%      | Sept.               | 10,829                             | - 24%           | 4.4                       |
| Canada        | Energy revenues expected to cut proposed 1982-83 fiscal deficit.                                      | July              | + 5%            | 246.5                  | - 0.1%      | Sept.               | 2,166                              | - 27%           | 0.4                       |
| United States | Signs emerge of a more widespread and intense economic downturn.                                      | Oct.              | + 2%            | 2,626.1                | - 0.2%      | Sept.               | 18,563                             | - 57%           | 0.8                       |

# New Corporate Bond Offerings Rising

The long-awaited bond rally finally seems to have arrived. Since late October, the yield on 30-year Treasury bonds has fallen by 200 basis points, which translates into a price increase of over 15%. The rally has been triggered not only by declining short-term interest rates, but by economic data indicating that the U.S. economy is clearly in a recession, and that it will be a number of months at best before a recovery in total spending begins.

Perhaps the most significant aspect of the rally is that institutional and retail demand for bonds has strengthened considerably. This is especially impressive in light of the heavy supply of Treasury issues and the potentially huge supply of new corporate bond issues coming to market in the near term.

The response of potential issuers to the shift in the demand for bonds and the resultant improved market conditions will be watched closely by bond-market investors in coming weeks. Already, the decline in long rates has induced a host of corporations to raise funds in the long-term market. Moreover, the potential exists for a further surge in new bond issues. Over the last few years, corporate liquidity has deteriorated significantly and corporate reliance on short-term debt has risen substantially, as many corporations postponed long-term issues in the expectation that market conditions would improve. For example, the ratio of short-term debt to total debt outstanding of manufacturing firms has risen

from about 15% in 1977 to close to 25%. Over the same period, the ratio of these firms' liquid assets to current liabilities fell from 28% to 19%.

Whether the developing surge in corporate bond offerings will eventually dominate increased investor demand for bonds—thus reversing the improvement in bond prices—is uncertain. First, it is difficult to gauge the extent to which investor sentiment toward bond investment has or is likely to change. Moreover, if the recent rally reflects a general decline in inflation expectations, some corporations may be reluctant to lock in "high" borrowing costs for the long haul—the converse of bond investors wishing to lock in "high" rates of return.

Yet it seems clear that there is a need for extensive restructuring of corporate debt before the recovery is well under way. In resolving this conflict, many corporations may seek to curtail long-term "lock-in" exposure by concentrating more on medium-term bonds—issues with maturities between 5 and 10 years, rather than 20 or 30 years.

At present, however, it appears that a sizable volume of new bond issues is already reflected in market prices, and thus can be accommodated without material price retreat. It is nonetheless quite possible that the actual volume of new issues may prove even greater than expectations. And such an occurrence could at least temporarily halt the cyclical bond recovery now in progress.

| OF PAYMENTS<br>of IMF<br>t. mil.<br>dollars | current influences on payments                                                        | MONEY AND BANKING |                                        |                |                     |                                           |                                  | COUNTRIES     |
|---------------------------------------------|---------------------------------------------------------------------------------------|-------------------|----------------------------------------|----------------|---------------------|-------------------------------------------|----------------------------------|---------------|
|                                             |                                                                                       | latest<br>date    | 12-month changes<br>consumer<br>prices | latest<br>date | money<br>supply(M1) | central<br>bank rate<br>November 18, 1981 | exchange rate<br>in U.S. dollars |               |
| 0                                           | Current account gap narrows owing to gains in international competitiveness.          | Sept.             | + 7%                                   | Aug.           | - 1%                | 6.75%                                     | .0640                            | Austria       |
| 0                                           | Trade and current account deficits continue to widen.                                 | Oct.              | + 8%                                   | June           | + 7%                | 13.00%                                    | .0267                            | Belgium       |
| 0                                           | Payments balance has worsened since January, but remains in surplus.                  | Oct.              | + 12%                                  | Aug.           | + 10%               | 14.625%                                   | 1.9245                           | Britain       |
| 0                                           | Current account remains in deficit.                                                   | Aug.              | + 12%                                  | June           | + 15%               | 11.00%                                    | .1396                            | Denmark       |
| 73                                          | Jan.-Sept. trade deficit was fmk. 7.2 million, vs. fmk. 5.2 million year earlier.     | Sept.             | + 11%                                  | May            | + 8%                | 9.25%                                     | .2309                            | Finland       |
| 0                                           | Estimated current account gap of \$6.5 bn. in 1981 could top \$10 bn. in 1982.        | Sept.             | + 14%                                  | June           | + 12%               | 9.50%                                     | .1777                            | France        |
| 0                                           | Current account set to improve markedly.                                              | Oct.              | + 7%                                   | Aug.           | - 1%                | 7.50%                                     | .4478                            | Germany       |
| 24                                          | New government to reexamine Greece's role in EEC.                                     | Aug.              | + 33%                                  | Feb.           | - 1%                | 26.00%                                    | .0185                            | Greece        |
| 0                                           | Jan.-Sept. trade deficit totaled £1.4 billion, versus £1.0 billion year ago.          | Aug.              | + 20%                                  | Aug.           | - 8%                | 16.50%                                    | 1.5840                           | Ireland       |
| 0                                           | Jan.-Sept. trade gap was 14.9 trillion lira, vs. lit. 13.6 trillion gap year earlier. | Oct.              | - 19%                                  | June           | + 11%               | 19.00%                                    | .00084                           | Italy         |
| 0                                           | Current account expected to be in surplus this year and next.                         | Oct.              | - 7%                                   | July           | + 1%                | 9.00%                                     | .4070                            | Netherlands   |
| 0                                           | Large current account surplus seen for 1981, thanks to oil.                           | Sept.             | + 13%                                  | June           | + 15%               | 9.00%                                     | .1727                            | Norway        |
| 63                                          | Sustained export demand weakness hurting trade balance.                               | Aug.              | + 22%                                  | June           | + 24%               | 18.00%                                    | .0165                            | Portugal      |
| 93                                          | Jan.-Aug. current account deficit totaled \$4 billion.                                | Aug.              | + 14%                                  | June           | + 10%               | 8.00%                                     | .01055                           | Spain         |
| 0                                           | Jan.-Sept. trade deficit was kr. 0.4 billion, vs. kr. 9.8 billion in year-ago period. | Sept.             | - 11%                                  | n.a.           | —                   | 11.00%                                    | .1828                            | Sweden        |
| 0                                           | Current account surplus of 2 billion Swiss francs expected this year.                 | Oct.              | - 7%                                   | July           | - 3%                | 6.00%                                     | .5618                            | Switzerland   |
| 0                                           | Canadianization being limited to energy industry.                                     | Oct.              | - 13%                                  | Aug.           | - 4%                | 16.13%                                    | .8464                            | Canada        |
| 0                                           | Recession could delay current account weakening.                                      | Sept.             | - 11%                                  | Oct.           | - 4%                | 13.00%                                    | —                                | United States |

# World Interest Rates

market rates of Nov. 18, 1981; bond yields as of Nov. 13, 1981

| in percent per annum                                                                                    | U.S.                                                                   | Canada                                                                                                                                                                                                                                                              | Britain                                    | Belgium                              | France                            | Germany                                                                                                                                                                                                            | Italy                                              | Netherlands                                                                                              | Switzerland                        | Japan                             |
|---------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------|--------------------------------------|-----------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------|----------------------------------------------------------------------------------------------------------|------------------------------------|-----------------------------------|
| <b>Central Bank Discount Rate</b>                                                                       | 13.00                                                                  | 16.13                                                                                                                                                                                                                                                               | 14.625<br><small>intervention rate</small> | 13.00                                | 9.50                              | 7.50                                                                                                                                                                                                               | 19.00<br><small>penalty rate 22.00</small>         | 9.00                                                                                                     | 6.00                               | 6.25                              |
| <b>Day-to-Day Money</b>                                                                                 | 13.00<br><small>Nov. 19</small>                                        | 20.50                                                                                                                                                                                                                                                               | 15.75                                      | 12.35                                | 15.625                            | 10.80                                                                                                                                                                                                              | 20.25                                              | 11.50                                                                                                    | 5.50                               | 7.375                             |
| <b>Treasury Bills</b><br><small>91-day, Middle Rates</small>                                            | 10.05<br><small>discount basis</small>                                 | 15.35                                                                                                                                                                                                                                                               | 14.00                                      | 15.00                                | n. a.                             | n. a.                                                                                                                                                                                                              | 19.297<br><small>59-day</small>                    | no dealing                                                                                               | no market                          | 5.625<br><small>two-month</small> |
| <b>Commercial Paper</b><br><small>prime, 3-month, asked</small>                                         | 11.50<br><small>finance paper discount basis</small>                   | 16.15<br><small>finance paper 15% tax w/h</small>                                                                                                                                                                                                                   | 13.23                                      | 12.90<br><small>Certified</small>    | 15.50<br><small>Interbank</small> | no market                                                                                                                                                                                                          | no market                                          | no market                                                                                                | no market                          | not traded                        |
| <b>Bankers' Acceptances</b><br><small>3-month, asked</small>                                            | 11.40                                                                  | 16.00<br><small>15% tax w/h</small>                                                                                                                                                                                                                                 | 14.00                                      | 12.90<br><small>Certified</small>    | not traded                        | 9.90                                                                                                                                                                                                               | 24.20                                              | no market                                                                                                | 9.50                               | no market                         |
| <b>Government Bonds</b><br><small>Long-term, new and old issues, average yield</small>                  | 13.51                                                                  | 15.05                                                                                                                                                                                                                                                               | 14.98                                      | 10.035<br><small>20% tax w/h</small> | 16.30                             | 10.02                                                                                                                                                                                                              | 21.48                                              | 11.86                                                                                                    | 5.73                               | 6.061                             |
| <b>Industrial Bonds</b><br><small>prime, long-term, new and old issues, average yield</small>           | 14.20<br><small>Aa Industrials</small>                                 | 16.00                                                                                                                                                                                                                                                               | 16.47                                      | 20.242                               | 17.65                             | 10.10                                                                                                                                                                                                              | 21.18                                              | 13.14                                                                                                    | 6.725                              | 7.18                              |
| <b>Bank Short-Term Rate</b><br><small>to Best Borrowers (prime rate)</small>                            | 16.50                                                                  | 18.00                                                                                                                                                                                                                                                               | 16.00                                      | 18.00                                | 17.35                             | 14.00                                                                                                                                                                                                              | 22.50<br><small>1/8 quar ly fee on outstg.</small> | 14.00                                                                                                    | 11.50                              | 6.75                              |
| <b>Bank Time Deposits</b><br><small>3-month</small>                                                     | 11.375<br><small>Cert. of Dep.</small>                                 | 12.75                                                                                                                                                                                                                                                               | 13.75                                      | 14.50                                | 15.50                             | 10.55                                                                                                                                                                                                              | 10.75<br><small>large deposits</small>             | 11.25<br><small>residents only</small>                                                                   | 8.75<br><small>20% tax w/h</small> | 4.25                              |
| <b>Eurocurrencies</b><br><small>3-month, asked</small>                                                  | 12.9375                                                                | no market                                                                                                                                                                                                                                                           | 14.9375                                    | no market                            | 16.75                             | 10.56                                                                                                                                                                                                              | no market                                          | 11.375                                                                                                   | 9.50                               | no market                         |
| <b>Exchange Rates—in U.S.\$</b><br><small>rates floating against the \$</small>                         | —                                                                      | .8474                                                                                                                                                                                                                                                               | 1.9250                                     | .02674                               | .1778                             | .4479                                                                                                                                                                                                              | .00084                                             | .4088                                                                                                    | .5618                              | .0045                             |
| <b>Forward Exchange Cover</b><br><small>3-month, in percent p. a.<br/>D = discount, P = premium</small> | —                                                                      | 3.22 D                                                                                                                                                                                                                                                              | 1.65 D                                     | 4.81 D                               | 3.63 D                            | 2.51 P                                                                                                                                                                                                             | 8.75 D                                             | 1.766 P                                                                                                  | 3.37 P                             | 5.40 P                            |
| <b>Eurodollar Deposits</b><br><small>(London, interbank, bid)<br/>November 19</small>                   | 7-day 12.4375<br>1-month 12.4375<br>3-month 12.0625<br>6-month 12.8125 | <b>International Arbitrage</b><br><small>(3-month, hedged)      + in favor of U.S. dollars</small><br>U.S.-U.K. Treasury Bills -1.908<br>U.S.-Canada Treasury Bills -1.327<br>U.S.-Canada Finance Co. Paper -1.208<br>Eurodollars-U.K. Local Auth. Deposits + .1625 |                                            |                                      |                                   | <b>Eurobonds</b><br><small>(average yield on recent straight debt issues)</small><br>U.S. Dollar Bonds<br>7 yrs. and under 14.25<br>Over 7 yrs. 14.50<br>DM Bonds<br>7 yrs. and under 9.9375<br>Over 7 yrs. 10.125 |                                                    | <b>Gold Price</b><br><small>London afternoon fixing</small><br>403.75<br><small>(per fine ounce)</small> |                                    |                                   |

The above interest rate quotations refer to the past week and may not be construed as offers by The Chase Manhattan Bank. The quotations for Bank Short-Term Rate to Best Customers, while including customary commissions, reflect neither possible other fees nor varying compensating balance requirements.

## Current economic indicators of major industrial countries

|                                                                                       | U.S.               | Canada            | Britain          | France             | Germany           | Italy                | Switzerland       | Japan           |
|---------------------------------------------------------------------------------------|--------------------|-------------------|------------------|--------------------|-------------------|----------------------|-------------------|-----------------|
| <b>Consumer prices*</b>                                                               | 11.0<br>(Sept.)    | 12.7<br>(Oct.)    | 11.7<br>(Oct.)   | 13.9<br>(Sept.)    | 6.7<br>(Oct.)     | 18.5<br>(Oct.)       | 7.3<br>(Oct.)     | 3.9<br>(Sept.)  |
| <b>Industrial production*</b>                                                         | 2.0<br>(Oct.)      | 4.6<br>(July)     | -1.9<br>(Sept.)  | -5.9<br>(Aug.)     | -1.9<br>(Sept.)   | 0.9<br>(Sept.)       | 0<br>(June)       | 3.8<br>(Sept.)  |
| <b>Trade balance†</b><br><small>(billions of local currency units)</small>            | -\$2.58<br>(Sept.) | CS0.06<br>(Sept.) | £0.01<br>(Sept.) | -FF8.46<br>(Sept.) | DM3.49<br>(Sept.) | Lit.2.150<br>(Sept.) | -SF0.44<br>(Oct.) | ¥748<br>(Sept.) |
| <b>Money supply (M1)*</b>                                                             | 4.2<br>(Oct.)      | 4.0<br>(Aug.)     | 10.2<br>(Aug.)   | 11.6<br>(June)     | 1.4<br>(Aug.)     | 11.2<br>(June)       | -2.5<br>(July)    | 3.0<br>(Aug.)   |
| <b>Velocity of money (M1)*</b>                                                        | 12.9<br>(Mar.)     | 7.2<br>(June)     | 9.8<br>(Dec.)    | n. a.              | 1.3<br>(June)     | 5.1<br>(June)        | n. a.             | 2.7<br>(June)   |
| <b>Reserves minus gold</b><br><small>(\$ million, change from previous month)</small> | 450<br>(Sept.)     | -300<br>(Sept.)   | -516<br>(Sept.)  | 1,670<br>(Sept.)   | 1,216<br>(Sept.)  | 384<br>(Sept.)       | 812<br>(Sept.)    | 342<br>(Sept.)  |

\* Percent change from 12 months earlier.

† Figures are only for the month indicated.

# A Break in the Export Credits Stalemate

The October meeting of the 22-member-nation OECD Export Credits Group achieved an important reduction in government subsidization of export credits. Failing to agree last spring to a virtual elimination of subsidies—by linking minimum allowable export credit rates specified in an international accord to market measures—the United States and its Canadian, European, and Japanese trading partners agreed to sizable increases in interest-rate minimums on government-backed export credits. The U.S. delegates, while reasonably satisfied with the upward adjustment, had sought higher rate increases. They regard the latest consensus as only an interim measure toward the ultimate goal of eliminating export credit subsidization altogether.

The agreement to boost minimum allowable rates by 2% to 2½ percentage points for officially supported export credits with maturities over two years (effective November 16) will have broad benefits. It will ease the fiscal burden of export subsidies in Europe somewhat. It will also mean that the United States, unable to provide the large rate subsidies it provided during the Carter administration because of profitability problems at the U.S. Export-Import Bank and retrenchment under the Reagan administration, will lose less ground in the export credits race than otherwise.

The increases in minimum permissible export credit rates mark the first major amendment of the 3½-year-old "Arrangement on Guidelines for Officially Supported Export Credits." The Arrangement spells out minimum interest rates for medium- and long-term export credits that entail some element of government financing; it also limits maturities on long-term credits. The guidelines are as follows:

|                                                                | 2-5 years<br>(percent per annum) | Over<br>5 years | Maximum<br>repayment<br>term<br>(years) |
|----------------------------------------------------------------|----------------------------------|-----------------|-----------------------------------------|
| Rich countries (GNP<br>per capita over \$3,000)                | 11.00                            | 11.25           | 8½                                      |
| Intermediate countries<br>(GNP per capita \$1,000-<br>\$3,000) | 10.50                            | 11.00           | 8½                                      |
| Poor countries (GNP per<br>capita less than \$1,000)           | 10.00                            | 10.00           | 10                                      |

Although the Paris accord fell short of U.S. and Canadian desires to link Arrangement rates with a proxy for world financial market movements, it represents an important accommodation to longstanding U.S. and Canadian demands for substantial minimum-rate increases. The U.S. Treasury estimates that the boost in rate minimums will reduce export finance subsidies by the industrialized nations by between 20% and 25%.

The major stumbling point in the talks was the low level of market interest rates in Japan. The European representatives to the negotiations might have consented to even larger rate rises if the Japanese could have agreed to do the same. But with the long-term prime rate in Japan at only about 8.9%, Japan has refused to extend export loans at rates that would far exceed its market rates. The compromise finally worked out will have the Japanese extending Japan Eximbank export credits at no lower than 9.25%, with commercial bank portions provided at market rates.

The consensus reached in Paris was significant, particularly in combination with movement on other fronts. The governments of the United States, France, Germany, and Britain agreed only this past summer to establish an interest-rate minimum of 12% on loans for purchases of competing commercial jet aircraft. In addition, the agreement to tighten up on "prior notification" procedures in the extension of the controversial "mixed credits" (a blend of export credit and aid) will make it easier for countries to match mixed credit offers by others.

Subsidies for both aircraft and all other categories of capital goods and industrial plant exports, however, will remain excessive, particularly in Europe. Long-term government bond rates in France, for example, are currently 16.3%, while the new government-backed export credit rate on 10-year loans to developing countries is 10%. In Britain, the interest-rate subsidization scheme is estimated to have cost over \$1 billion in the fiscal year ended March 1981.

For the United States, the rise in minimum export credit rates will mean that U.S. Eximbank-backed rates will be uncompetitive, rather than highly uncompetitive. The U.S. Eximbank has already cut back its subsidies sharply by raising its direct loan rate for medium- and long-term credits sharply to halt a deterioration in its net-income position. The bank's loose-fisted lending policies under the Carter administration—which chose to stress the bank's mandate to provide "competitive" financing over its mandate to remain "self-sustaining"—had it extending direct loans at about 8.0%-8.50%, while its borrowing costs shot up steadily in line with the rise in market rates. Moreover, the volume of direct lending under the former administration soared to more than \$4 billion in fiscal 1980 from \$700 million in fiscal 1977. The result was the prospect of an operating loss of \$100 million in fiscal 1982.

Eximbank's new chairman, William Draper, responded to the problem quickly. Although he lifted a five-month-old moratorium on bank lending, he boosted the direct-loan interest rate in July to 10.75%

## A Break in the Export Credits Stalemate *(continued from page 7)*

from 8.75% and imposed a two-percentage-point up-front surcharge on Eximbank credit values. (On a 10-year loan, the bank estimates that the fee raises the interest cost of an Eximbank credit by  $\frac{1}{2}$  percentage point.) And on November 12, he boosted the bank's direct loan rate again to 12%. With respect to the allocation of its resources, the Eximbank will not provide credit support for export sales to developed or industrialized countries; will no longer extend general purpose "lines of credit"; will not finance old-generation aircraft; and will encourage greater use of financial guarantees of private credit. It will, however, continue to provide as much as 65% credit, in participation with private funds.

Recognizing the reduced financing competitiveness that its new direct loan rate policies entail—despite the increases in Arrangement minimums—the U.S. Eximbank is expected to reserve the right to extend repayment terms beyond the maximums specified in the Arrangement in special cases, an option that it has already exercised on several occasions. Furthermore, support from Congress and the administration for a "war chest," or emergency fund, to help the U.S. retaliate selectively against countries providing mixed credits and extending loans at the Arrangement minimums, is likely to persist. And Eximbank Chairman Draper has stated that by improving the bank's financial condition, the higher rates will allow the bank to target its resources more effectively to match foreign offers in important cases.

It is difficult to tell whether the U.S. Eximbank's powers of persuasion will be adequate to prod the Europeans and Japanese to consent to still further rises in the Arrangement rate minimums and ultimately to market-rate linkage. The United States hopes so. It will push for another three-percentage-point hike in minimum rates when the OECD Export Credits Group reconvenes in March.

America's competitors may, however, be disinclined to regard it as a serious challenger in the export credits race, with U.S. Eximbank loan activity curtailed and its loan costs high. For fiscal 1982, the Reagan administration has requested cutting back the bank's direct loan authority to \$3.87 billion. This compares with a \$5.02-billion ceiling in fiscal 1981 and with the \$5 billion requested by the Carter administration for fiscal 1982. The Reagan government, in advocating reduced Eximbank lending, has maintained that the Eximbank's loans have little impact on expanding U.S. exports. Moreover, the U.S. Office of Management and Budget has stressed that only a few large firms which do not really need Eximbank support continue to benefit from the bank's loan program.

Still and all, there is a chance that the Eximbank's actual lending authority for fiscal 1982—as yet undecided—will exceed the \$3.8 billion requested by the White House. Pressure from the business community did succeed in restoring about one-third of fiscal 1981 loan authority cut by President Reagan. And with U.S. unemployment at 8.0% and rising, there is sympathy for the argument about the adverse impact of Eximbank cuts on employment. In addition, Eximbank officials stress that since foreign governments continue to provide large subsidies, Eximbank aid is needed to neutralize them.

Regardless of funding levels, however, Eximbank's direct loan costs are likely to remain high. An Eximbank-backed 10-year credit to a buyer in a good-risk developing country is currently priced at 13.50%-14.00% per annum, exclusive of fees. This would entail Eximbank funds covering 50% of the overall credit, with a commercial bank loan at  $\frac{1}{2}$ -1 percentage point over the London Interbank Offer Rate for the remainder. Such a U.S. "blended rate" compares poorly with those on export credits overseas. The comparable U.K., French, and Italian rates, for example, are 10% (the new minimum), with the Japanese blended rate lower still.

In sum, the recent success in Paris will undoubtedly ease the level of trade-distorting subsidization of export credits by the industrialized nations. And it will take some of the pressure off the U.S. Eximbank to compensate in some fashion for its uncompetitive financing terms. Nonetheless, market rates in Europe and the United States are still far above the new minimum allowable export credit rates, keeping trade-distorting subsidies high and making the need for further increases in rates pressing. In addition, there exists a plethora of non-interest-rate subsidy schemes offered abroad—including inflation indemnity and exchange-rate fluctuation protection—that are outside the Arrangement's purview and that need addressing.

A real breakthrough in the export credits area would be agreement on some mechanism whereby the Arrangement's minimum export credit rates will move permanently in line with market rates. The "managed system" agreed on in October, however, appears to be the most that is currently obtainable. Under this arrangement, OECD members will meet periodically to consider readjusting rate minimums, depending upon the prevailing interest rate of the IMF's Special Drawing Right. The U.S. hope is that Europe's willingness to boost minimum rates is indicative of a shift in philosophy, rather than a one-time accommodation, and presages further such increases at future review sessions toward the ultimate goal of subsidy-free long-term export financing.

*David M. Cheney*